

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MEADE COUNTY)	
RURAL ELECTRIC COOPERATIVE)	
CORPORATION FOR AN INCREASE IN RATES)	CASE NO. 10266
TO FLOW THROUGH A WHOLESALE POWER)	
COST INCREASE)	

O R D E R

On June 23, 1988, Meade County Rural Electric Cooperative Corporation ("Meade County") filed with this Commission its notice of increase in rates for retail electric service to become effective on January 1, 1989; to flow-through the increase in wholesale rates proposed by Big Rivers Electric Corporation ("Big Rivers") in Case No. 10265, Big Rivers Electric Corporation's Notice of Changes in Rates and Tariffs for Wholesale Electric Service. The proposed rates would produce additional revenue of \$1,012,887 annually, an increase of 7.5 percent based on normalized test-year revenues. On July 19, 1988, the Commission ordered Meade County to provide evidence, including pro forma adjustments and prepared testimony, as to why it should not be required to absorb a portion of the Big Rivers' wholesale purchase power increase. Meade County filed its response on August 11, 1988.

On July 29, 1988, the Commission issued a procedural Order suspending the proposed increase in rates for a period of 5 months, until January 1, 1989, in order to conduct public hearings and investigations into the reasonableness of the proposed rates.

A hearing was scheduled for December 2, 1988 for the purpose of cross-examination of the witnesses of Meade County and the intervenors. Meade County was directed to provide statutory notice to its consumers of the proposed rate increase and the scheduled hearing pursuant to 807 KAR 5:011, Section 8.

The Commission granted the Motion to Intervene filed by the Utility and Rate Intervention Division of the Office of the Attorney General. There were no other intervenors in this proceeding.

The hearing was conducted in the Commission's offices in Frankfort, Kentucky, on December 2, 1988. The information requested during the hearing has been submitted.

COMMENTARY

Meade County is a consumer-owned rural electric cooperative corporation, organized under Chapter 279 of the Kentucky Revised Statutes, engaged in the distribution and sale of electric energy to approximately 17,680 member-consumers in the Kentucky counties of Breckinridge, Grayson, Meade, Hardin, Ohio, and Hancock. Meade County has no electric generating facilities of its own, and purchases all of its power from Big Rivers, of which Meade County is one of four members.

TEST PERIOD

Meade County proposed, and the Commission has accepted, the 12-month period ending December 31, 1987 as the test period for determining the reasonableness of the proposed rates. To make the historical test period more reflective of expected future needs, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

Meade County did not present a net investment rate base in this proceeding. A net investment rate base has been calculated, based on the test-year-end value of plant in service, the 13-month average for materials and supplies, and prepayments, and deducting the proposed pro forma accumulated depreciation and customer advances for construction at the end of the test period. Also included was working capital based on one-eighth of operation and maintenance expenses, exclusive of depreciation, taxes and other deductions. The working capital has been adjusted to reflect the pro forma adjustments to operation and maintenance expenses found reasonable.

Based on these adjustments, Meade County's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	\$19,959,229
Construction Work in Progress	6,470
Total Utility Plant	<u>\$19,965,699</u>
ADD: Materials and Supplies	\$ 290,091
Prepayments	59,172
Working Capital	261,974
Subtotal	<u>\$ 611,237</u>
DEDUCT: Accumulated Depreciation	\$ 5,319,277
Customer Advances for Construction	43,522
Subtotal	<u>\$ 5,362,799</u>
NET INVESTMENT	<u><u>\$15,214,137</u></u>

Capital Structure

The Commission finds, from the evidence of record, that Meade County's capital structure at the end of the test period for

rate-making purposes was \$18,374,507 and consisted of \$7,858,218 in equity and \$10,516,289 in long-term debt. In this determination of the capital structure, the Commission has excluded accumulated generation and transmission capital credits ("GTCCs") assigned from Meade County's wholesale power supplier in the amount of \$1,238,302.

The Commission has given due consideration to these and other elements of value in determining the reasonableness of the proposed rate increase.

REVENUES AND EXPENSES

Meade County proposed several adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes, with the following modifications:

Purchase Power Expense

The Commission's fuel adjustment clause affects both revenues and purchased power expense. Although fuel revenue was correctly accounted for in the operating revenue figures submitted by Meade County in the initial filing, purchased power expense was not properly adjusted. The Commission has reduced Meade County's purchase power expense by \$30,338 to remove fuel expense improperly included in the operating expense of Meade County.

Considering the test-year load factor of 46.87 percent to be abnormal, Meade County has proposed an adjustment of \$276,015 to reflect the 5-year average load factor of 44.48 percent. With the introduction of wholesale demand ratchet in Big Rivers' last rate

case, Meade County's wholesale power costs have become more sensitive to weather-related fluctuations in load factor. Some adjustment to reflect normal load factor therefore may be appropriate. Such an adjustment must be based on sound analytic study of all factors affecting Meade County's load demand. Meade County has not conducted such a study. Therefore, the Commission cannot accept the proposed adjustment.

Payroll

Meade County proposed to increase its test-year labor expense by \$51,946. The proposal reflected a 5 percent pay increase effective January 24, 1988. Meade County calculated the increase by applying the percentage increase to the test-year payroll expense.

The Commission is of the opinion that this adjustment should be calculated by applying the January 24, 1988 hourly wage rates to the normalized hours worked and the actual overtime hours. Hours worked for employees who terminated employment were excluded from the calculations and wages for part-time employees were calculated using the test-year actual hours worked. Normalized work hours are determined as 8-hour days, at 5 days a week for 52 weeks or 2,080 hours. Meade County had indicated in its response to informational requests that 2,160 hours had been worked; however, this figure included one accrued payroll period.

Based on the above, the Commission has determined Meade County's pro forma payroll cost to be \$1,592,789 and has applied the 28.61 percent capitalization rate to calculate the adjustment

to payroll expense. As a result, the Commission has increased payroll expense by \$98,192 to a level of \$1,137,091.

FICA, Federal and State Unemployment Taxes

Meade County proposed adjustments to increase its FICA tax by \$3,754, and to decrease its Federal Unemployment tax by \$492 and its State Unemployment tax by \$560. These proposals reflect an increase in the FICA rate from 7.15 percent to 7.51 percent, a decrease in the Federal Unemployment rate from .8 percent to .6 percent, and a decrease in the State Unemployment rate from .9 percent to .7 percent.

These proposed adjustments overlook or exclude information necessary to accurately calculate the adjustments. The FICA adjustment did not consider the increase in base wage limit from \$43,800 to \$45,000. The Federal Unemployment tax rate remained unchanged from 1987. The Commission has incorporated this information in determining any increase in payroll taxes.

The Commission has determined that payroll taxes should be increased by \$8,533. FICA taxes should be increased by \$9,001; Federal Unemployment taxes should be increased by \$46; and State Unemployment taxes should be decreased by \$514. The Commission's calculations are based on the application of the appropriate tax rates and base wage limits to the pro forma payroll cost determined in the Payroll Section of this Order. The resulting costs were adjusted by applying the capitalization rate of 28.61 percent to the cost.

Workers' Compensation

Meade County proposed to increase its test-year workers' compensation expense by \$2,539. The proposed adjustment was developed to reflect the effective payroll rate as of the test-year-end. At the hearing, Meade County acknowledged that the workers' compensation rates used in the adjustment calculations had been obtained by Meade County employees from its workers' compensation insurance policy and in effect reflected a net rate, incorporating the actual rates, an experience modification factor, and the Kentucky Special Fund Assessment. At the hearing, Meade County was requested to file the current worker's compensation policy; this was done December 6, 1988.

The Commission is of the opinion that the rates and factors from the current policy should be used in this adjustment. The Commission has calculated the pro forma labor subject to workers' compensation in the same manner as Meade County based upon the pro forma labor determined to be reasonable by the Commission. Therefore, the Commission has determined that workers' compensation expense should be increased \$12,562 over the test-year actual expense.

Interest Expense

Meade County's actual test-year interest expense was \$549,872. Meade County proposed to increase its interest expense on long-term debt by \$54,489. The proposal reflected the use of the interest rates in effect for Meade County as of August 11, 1988, applied to the test-year-end balances for its long-term debt.

In determining Meade County's revenue requirements, the Commission has included the annual interest expense based on the balance of long-term debt outstanding at the end of the test year and the current interest rates supplied by Meade County at the December 2, 1988 hearing. Accordingly, the Commission has increased interest expense by \$68,019 to \$617,891.

National Rural Electric Cooperative Association ("NRECA") Retirement Expense

Meade County proposed to increase its test-year retirement expense by \$22,421. The proposal reflected a change in the retirement cost rate effective January 1, 1988 and a normalization of the retirement cost for a full year due to the moratorium on these costs in 1987. The moratorium had been declared to keep the NRECA retirement program from moving ahead of its funding schedule. The moratorium, which began in July 1987, will be continued at least until December 31, 1989.

In a November 1987 Bulletin, NRECA instructed all participating cooperatives on pension plan disclosure requirements, pursuant to Statement of Financial Accounting Standards No. 87. On the subject of the moratorium, the NRECA advised that a moratorium on contributions imposed by the full funding limitation should be noted but not expensed nor recognized as cost during the period. For rate-making purposes, the Commission finds that Meade County will not pay any retirement costs in 1988 or 1989. It is uncertain when the retirement payments will resume, and it is not reasonable to include in the revenue requirements determination, an expense which will not actually be incurred. Thus, Meade

County's proposed adjustment has not been included herein, and the retirement expense of \$34,178 incurred in the first half of the test year has been deducted from test-year expenses.

The effect of the pro forma adjustments on Meade County's net income is as follows:

	<u>Test Period Reported</u>	<u>Pro Forma Adjustments</u>	<u>Test Period Adjusted</u>
Operating Revenues	\$12,070,704	\$2,440,237	\$14,510,941
Operating Expenses	10,975,735	2,151,778	13,127,513
Operating Income	<u>\$ 1,094,969</u>	<u>\$ 288,459</u>	<u>\$ 1,383,428</u>
Interest on Long-Term Debt	549,872	68,019	617,891
Other Income and <Deductions> - Net	<u>138,244</u>	<u>-0-</u>	<u>138,244</u>
NET INCOME	<u><u>\$ 683,341</u></u>	<u><u>\$ 220,440</u></u>	<u><u>\$ 903,781</u></u>

REVENUE REQUIREMENTS

The actual rate of return earned on Meade County's net investment rate base established herein for the test period was 7.20 percent. In the response to the August 11, 1988 Order, Meade County proposed adjustments that resulted in an adjusted Times Interest Earned Ratio ("TIER") of 2.02X and a rate of return of 7.12 percent.

Meade County's actual TIER for the test period was 2.24X and was 1.89X and 2.54X for the calendar years 1985 and 1986, respectively. After taking into consideration the pro forma adjustments allowed by the Commission, in this case, Meade County would achieve a TIER of 2.46X, assuming a complete flow-through without any absorption. Meade County's equity to total asset ratio is 37.86 percent based on the capital structure approved herein.

Meade County's Debt Service Coverage for the test period and calendar years 1985 and 1986 was 2.19X, 1.89X and 2.33X, respectively. All of these ratios are based on the earnings of Meade County exclusive of the GTCCs assigned by Meade County's wholesale supplier, Big Rivers.

In 1982, Meade County was granted a rate of return of 7.70 percent which provided a TIER of 2.25X. The Commission is of the opinion that Meade County should be required to absorb a portion of the Big Rivers' purchased power increase. In order to achieve a TIER of 2.25X, Meade County should be required to absorb \$131,417 of the \$1,011,918 increase in purchased power expenses. This additional revenue should produce net income of \$772,364 and a rate of return of 8.23 percent, which should be sufficient to meet the requirements in Meade County's mortgages securing its long-term debt.

RATE DESIGN

The increased power cost resulting from the rate increase granted to Big Rivers, Meade County's wholesale power supplier, will be allocated by the method which Meade County proposed in the initial filing.

SUMMARY

The Commission, after consideration of the evidence of record, and being advised, is of the opinion and finds that:

1. The rates in Appendix A, attached and incorporated hereto, are the fair, just, and reasonable rates for Meade County and will produce gross annual revenues based on normalized test-year sales of approximately \$14,379,524.

2. The rate of return and TIER granted herein is fair, just, and reasonable and will provide for the financial obligations of Meade County.

3. The adjustments as determined herein indicate that Meade County should absorb \$131,417 of the purchased power increase from Big Rivers.

4. The rates proposed by Meade County would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A be, and they hereby are, approved for service rendered by Meade County on and after January 1, 1989.

2. The rates proposed by Meade County be, and they hereby are, denied.

3. Within 30 days from the date of this Order, Meade County shall file with this Commission its revised tariff sheets setting out the rates approved herein.

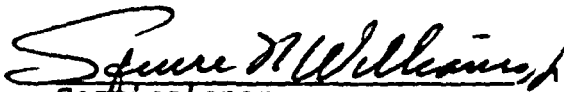
Done at Frankfort, Kentucky, this 27th day of December, 1988.

PUBLIC SERVICE COMMISSION

Chairman


Vice Chairman

ATTEST:


Commissioner

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 10266 DATED 12/27/88

The following rates and charges are prescribed for the customers in the area served by Meade County Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

RATE SCHEDULE 1 - RESIDENTIAL, FARM AND NON-FARM, SCHOOLS AND CHURCHES

Customer Charge - No KWH Usage	\$4.33
First 300 KWH Per Month	.06924
Next 700 KWH Per Month	.05506
All Over 1,000 KWH Per Month	.05102

RATE SCHEDULE 2 - COMMERCIAL RATE

Customer Charge - No KWH Usage	\$4.33
First 500 KWH Per Month	.07431
Next 500 KWH Per Month	.06813
All Over 1,000 KWH Per Month	.06022

RATE SCHEDULE 3 - GENERAL SERVICE, 0-49 KVA

Customer Charge - No KWH Usage	\$4.33
First 500 KWH Per Month	.07180
Next 500 KWH Per Month	.06638
All Over 1,000 KWH Per Month	.05832

Demand Charge

First 10 KW of Billing Demand	No Charge
Excess Above 10 KW of Billing Demand	\$2.99 Per KW

**RATE SCHEDULE 4 - LARGE POWER SERVICE
50 KVA - 999 KVA**

Demand Charge

Per KW of Billing Demand	\$2.99
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Energy Charge

First 100 KWH Used Per KW of Billing Demand	\$.06083
Next 100 KWH Used Per KW of Billing Demand	\$.05476
Next 100 KWH Used Per KW of Billing Demand	\$.05224
All Remaining KWH Used	\$.05070

**RATE SCHEDULE 5 - OUTDOOR LIGHTING SERVICE
INDIVIDUAL CONSUMERS**

175 Watt Unmetered - Per Month	\$6.91
175 Watt Metered - Per Month	3.65
400 Watt Unmetered - Per Month	9.60
400 Watt Metered - Per Month	3.65

**RATE SCHEDULE 6 - STREET LIGHTING SERVICE
COMMUNITY, MUNICIPALITIES AND TOWNS**

175 Watt - Per Month	\$6.03
400 Watt - Per Month	8.79